

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
PLR-121756-07
Date: May 7, 2008

Legend:

X =

D1 =

D2 =

Trust =

Dear :

This letter responds to a letter dated May 2, 2007, and subsequent correspondence, written on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

According to the information submitted, X was incorporated on D1 and elected under § 1362(a) to be an S corporation, effective D1. On D2, shares of X stock were transferred to Trust. Trust is represented as being eligible to be an electing small business trust (ESBT) as of D2. However, the trustee of Trust failed to make a valid ESBT election, effective D2. Consequently, X's S corporation election terminated on D2.

X represents that the failure to file the ESBT election for Trust was not motivated by tax avoidance or retroactive tax planning. X further represents that X and its

shareholders have consistently treated X as an S corporation at all times since D1, and that X's shareholders have consistently included their distributive shares of X's income on their respective federal income tax returns. Finally, X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(v) provides that for the purposes of § 1361(b)(1)(B), an ESBT may be a shareholder in an S corporation.

Section 1361(e)(1)(A) provides that, except as provided in § 1362(e)(2)(B), the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides that the trustee must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement meeting the requirements of § 1.1361-1(m)(2)(ii).

Section 1.1361-1(m)(2)(ii) provides that the election statement must include (A) the name, address and taxpayer identification number of the trust, the potential current beneficiaries, and the S corporation in which the trust currently owns stock; (B) an identification of the election as an ESBT election made under § 1361(e)(3);

(C) the first date on which the trust owned stock in each S corporation; (D) the date on which the election is to become effective (not earlier than 15 days and two months before the date on which the election is filed); and (E) representations signed by the trustee stating that the trust meets the requirements of § 1361(e)(1) and all potential current beneficiaries of the trust meet the shareholder requirements of § 1361(b)(1).

Section 1.1361-1(m)(3)(i) provides that if a trust makes a valid ESBT election, the trust will be treated as an ESBT for purposes of chapter 1 of the Internal Revenue Code as of the effective date of the ESBT election.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

For S corporation elections made and terminations occurring before January 1, 2005, § 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on D2 because of the failure to file an ESBT election for Trust, and that the termination was inadvertent within the meaning of § 1362(f). We further conclude that, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from D2, and thereafter, provided X's S corporation election was valid, and provided that the election is not otherwise terminated under § 1361(d). Trust will be treated as an ESBT from D2, provided that Trust is otherwise eligible to be an ESBT, until its ESBT status terminates.

This ruling is conditioned upon the trustee of Trust filing a properly completed ESBT election effective D2, with the appropriate service center within 60 days following the date of this letter. A copy of this letter should be attached to the ESBT election.

Except as specifically set forth above, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied as to whether X otherwise qualifies as a subchapter S corporation under § 1361, and whether Trust meets the requirements to be an ESBT under § 1361(e).

Under a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

This ruling is directed only to the taxpayer requesting it. Pursuant to § 6110(k)(3) of the Code, this ruling may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes